

# CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 317

August 25, 1966

## SAVINGS AND LOAN ASSOCIATIONS: BAD DEBT RESERVE UNDER REGULATION 24348(a)

### Syllabus:

A method frequently used by savings and loan associations in selling property which they have acquired upon foreclosure of a defaulted loan is to enter into a contract of sale with the buyer. A contract of sale is used because the buyer cannot make a sufficiently large down payment to warrant the seller making a loan for the balance of the purchase price and transferring title to the buyer in exchange for the buyer's note and deed of trust. Customarily, when a specified percentage of the purchase price is paid under the contract by the buyer, e.g., 20 percent, the contract is replaced by a note and deed of trust and title is transferred to the buyer. Under a contract of sale, the savings and loan association does not make a loan to the buyer on a promissory note for the unpaid amount of the contract price.

The question is asked whether the unpaid balance of contracts of sale ought to be included in outstanding receivables in determining the bad debt deduction. The question is presented with respect to computing the 20-year average bad debt loss experience as prescribed by Reg. 24348(a). It is concluded that such contracts of sale may not be included.

It may be stated as a general concept that a contract of sale does not create a monetary debt. It creates only an obligation to perform the acts specified in the contract. Pickering Lumber Corp. v. Whiteside, 54 Cal. App. 2d 200, 206. The obligation of the purchaser to pay the purchase price is not a mortgage debt. 50 Cal. Jur. 2d Vendor and Purchaser § 95. If the purchaser defaults in payment of the contract and the seller seeks to recover the unpaid purchase price, the seller brings an action on the contract and not on a debt. Idem § 608. The sale of one's own property is not a loan regardless of the terms of the purchase. See Eisenberg v. Greene, 175 Cal. App. 2d 326; Lagorio v. Yexa, 96 Cal. App. 111. The cases would amply support a distinction between the obligation resulting from a contract of sale and a promissory note indebtedness arising from a loan of the purchase price.

A review of past rulings pertaining to the bad debt allowance for financial organizations establishes that contracts of sales have been consistently excluded from the category of outstanding loans.

The Uniform Classification of Accounts promulgated in regulations of the

Savings and Loan Commissioner (10 Cal. Adm. Code, Ch. 2, Subch. 1) requires separate accounts for loans and for contracts. Likewise, separate accounts are required for losses from loans and for losses from sales of property. This classification, while not determinative, clearly supports a distinction in treatment.

The matter was not touched upon in the formulation of Regulation 24348(a). However, it must be presumed that the regulation was prepared with knowledge of the existence of the prior rulings. It is therefore concluded that in the absence of an expression that a change was intended the substance of those rulings ought to be followed with respect to the present regulation.